

STRATEGY 6 IMPROVING FINANCIAL PLANNING AND CONTROL SYSTEMS

The traditional financial concerns of government emphasise probity. Public money must be fully accounted for, and procedures must emphasise upward reporting of financial decisions, and strict enforcement of tightly specified budget headings.

Current reforms are underpinned by fundamental changes in the emphasis of financial management systems. The concern with probity is matched by a growing concern to enable managers within government to act as public sector entrepreneurs, fully utilising the value of capital, goods, and staff within government to deliver specified objectives.

OUTPUT-ORIENTED SYSTEMS

Major procedural and policy shifts have affected public service financial management, making it performance or output-oriented. Budgets are determined on the basis of the goods or services – the outputs – of a department or agency. In effect, government is purchasing a specified quantity and quality of services from the public service.

This significant shift in orientation is accompanied by other developments, including the provision of efficiency dividends to departments (U.K., Australia), the introduction of charges for the use of capital (New Zealand), payments by departments for internal government services (Australia), and a shift from cash to accrual accounting (New Zealand and U.K.).

In 1990, the Government of Malaysia introduced the Modified Budgeting System (MBS). The objective of the MBS is to improve the budgetary process, particularly in relation to accountability, allocation of resources and the implementation of programmes by government agencies.

MBS stresses the relationship between inputs, outputs and the impacts of a particular programme or activity. Under this system, government agencies are required to determine their achievement targets in terms of outputs and impacts of every programme or activity for which there are 'Programme agreements' between the agency and the Federal Treasury.

In providing performance measurement of programmes/activities, the MBS is in line with the 'value for money' concept which strives to achieve three objectives: economy, efficiency and effectiveness.

- New Zealand's financial reporting is completely output-oriented, and Malta and Australia carry out three-year forward plan estimates.

DELEGATION

The move towards an output orientation fixes attention on the range, quality and volume of services which government is seeking to provide within its financial allocations. Delegation of financial responsibility gives managers some leeway to consider alternative methods for ensuring that those agreed services are provided.

In the U.K., the introduction of delegated budgetary responsibilities necessitated the development of new financial management procedures. Under the traditional system, managers were excluded from controlling a number of non-cash resource items, such as depreciation, cost of capital, debtors, creditors, stock balances, and rents. The focus, and assessment of performance, on the basis of value for money criteria, has implied the need for financial management information which shows how total resources are applied and managed, in addition to information on cash payments and receipts.

- In New Zealand, this approach is developed to the point where Ministers are effectively purchasing the outputs (goods and services) from departments. The outputs required from departments are precisely detailed in the specification of the performance required of the fully accountable chief executives. This provides room for entrepreneurial flexibility in meeting targets by offering them greater control over the purchase, use and sale of departmental assets necessary to produce the required outputs.
- The delegation of authority to levy user charges on corporate customers for some academic institutions in India is providing an incentive to market services more actively.
- Australia has introduced user-pays principles to public sector agencies, so that when one part of government needs a service from another, it is increasingly common that it has to pay for it. The purpose of this approach is to make it clear to managers that nothing is cost-free and to encourage them to modify their behaviour accordingly. Before ordering a service, the manager who has to pay for it will ask whether or not it is essential.

INTRODUCING ACCRUAL ACCOUNTING

Experience in this area is very strongly influenced by the innovations implemented within the New Zealand public sector.

Good practices in decision-making on the allocation of resources, and in the specification and subsequent assessment of financial performance, require financial information that is timely, relevant and reliable. Since cash accounting records

money received at the time it is banked and money spent at the time it is paid out, it does not provide sufficient information to measure the full cost of producing goods and services in a given period. It also provides only limited information on the value of assets and liabilities.

While cash-based accounts give an accurate view of an entity's cash flows, accrual-based accounts give a fuller picture of its operations and overall financial position, since it relates activities to the period in which costs are incurred or revenue is earned, regardless of when or whether money changes hands. It keeps track of assets and liabilities, and records changes in their values.

Accrual reporting thus gives a clearer view when financial implications extend beyond a year and encourages a longer-term focus in decision-making. It also facilitates more meaningful assessment by ministers and legislators of the performance of government entities and of the managers responsible for them.

Accrual accounting is a logical tool of accountability when viewed from purchase and ownership perspectives. In the case of departments, the government is often the principal purchaser of their output (the goods and services produced) and at the same time is their owner.

The information yielded by accrual accounting is of use in the specification and assessment of performance in respect of both output delivery and stewardship of assets. The purchase interest requires information on quantity, quality, time and place of delivery, and cost of outputs. The ownership interest requires financial information which distinguishes capital and current expenditure and revenue, and reflects a notion of capital maintenance. Accrual accounting provides information relevant to these interests and facilitates comparisons between competing providers.

The period required to implement full accrual accounting is heavily dependent on the level and availability of accounting skills.

Public sector reform in the U.K. has demonstrated the need for additional, more robust indicators of financial performance than traditional cash-based accounting arrangements can provide. New accrual-based financial reporting is seen as an adjunct to traditional cash reporting (not a replacement for it), which will enhance the tools available to assess and reflect performance in terms of value for money. The U.K. Treasury is introducing a pilot study on accrual accounting in a number of departments. The study will consider:

- whether the new system is demonstrably useful to departments in terms of allocating resources and improving value for money;
- whether the cost of introducing the new system is reasonable;
- whether it will provide information to Select Committees, MPs, academics and the public, in terms of enhanced accountability.

- In New Zealand, the move from cash to accrual accounting was scheduled to take two years. This involved departments specifying their outputs as well as installing new computer software, and introducing new banking, costing, monitoring and reporting systems. The scale of the change to long-established procedures was huge. Most departments employed consultants to assist with the transition, and many have retained staff with scarce skills on contract.

CAPITAL CHARGING

Capital charging underlines the significance of good estate management. Traditionally, capital investment has been a free good for public service managers. This has not encouraged the responsible use of assets and has led to over-bidding for capital funds. The developments in the U.K., and in other settings, indicate the growing concern of governments to ensure that fixed assets are fully utilised and regarded as investments requiring careful husbandry. The end point of these developments is to ascertain a real cost for services, to heighten efficiency and economy.

If departments do not bear the cost of capital, they may be seen as the preferred provider, even when more efficient producers exist. Ignoring this cost is likely to result in poorly informed decision-making and misallocation of resources. Very particularly, the government is more likely to achieve value for money when capital is no longer treated as being free, because the bias in favour of capital-intensive production is addressed.

Reform programmes recognise that if the prices charged for government services do not recover the total costs, including the cost of capital, then the government is effectively providing a subsidy. This may or may not be the government intention, but a government should be in position to decide explicitly whether, and to what degree, to subsidise a particular activity.

In the U.K., government capital charging operates at two levels:

- The general, externally imposed rule that departmental trading units and Agencies must include in their costs (on which their performance is partly based), interest on capital at a rate fixed by the Treasury. This is part of working to a "full economic cost" (FEC) base.
- Within Agencies of central government, the National Health Service and local government in the U.K., interest is normally charged within the management (internal) accounts to impress upon local managers the real costs of the assets they hold and thereby encourage efficient use of them.

Capital charges are most effective when combined with a consistent financial management framework and accrual accounting. Together, these changes provide departmental chief executives with the opportunity, incentive and information to produce desired "outputs" at the lowest cost.

- Before implementation, reliable information on the net assets of departments must be available. In New Zealand this information is provided in audited accrual accounts (including a balance sheet) which all departments are required to produce. The financial management reforms in New Zealand have illustrated the significance of adopting appropriate accountancy approaches from other sectors. Capital charging ensures that the opportunity costs of tying up capital within departments are fully captured.

IMPROVING ESTATE MANAGEMENT

Land, buildings, equipment and infrastructure owned by the government (the estate) represent a massive accrued investment. This huge resource is commonly neglected and often not systematically recorded or valued. Management of this resource is now being recognised as a key area for reform and development.

Increased awareness and understanding of the size, nature, value and condition of property, coupled with increased management authority, responsibility and accountability for the estate, brings added value-for-money to the public sector's mainstream activities by allowing for better use of these assets and releasing cash and management time. By making it apparent that the estate is not available free of charge, by allocating management time to its active development, by making the estate finances visible, and by demonstrating a committed will to change ingrained habits and behaviours, the estate can and should make a valid contribution to better value-for-money from government expenditure.

Since the estate is a part of mainstream activity it should feature as strongly as other topics in mainstream management training courses. The objective should be to train managers to take an active and informed interest in the whole of their asset base. Managerial awareness will increase if managers' performance on their property assets is judged and valued with the same vigour as their people management or financial skills.

Based on the experience of New Zealand, a programme for improving estate management, should consider the following:

Local managers are, more often than not, unaware of their estate ownership, occupation and physical condition. A basic database will permit key decisions to be made on the future of the estate portfolio. The following should be considered:

- an inventory of assets, including the type of land holding/tenancy;
- an assessment of their condition and future maintenance needs;
- an appraisal of the functional suitability of the assets; and
- valuation of the asset, based on its existing use and, for comparison, its alternative use value.

In constructing and making use of such an inventory, senior management is committing itself to the development of their estate. Senior management commitment is an essential pre-requisite to active and radical estate management.

To enable property to play a part in the organisation's strategic business plan, it is necessary to devise an estate strategy designed to promote occupational efficiency, fitting within the overall business strategy. Such a strategy will cover the identification of:

- accommodation that is well suited to current needs;
- surplus land;
- assets requiring improvement or alteration to make them fit for today's needs and tomorrow's demands; and
- land and property that is surplus to requirements and which should be used for other purposes or disposed of.

An accurate analysis of these dimensions will enable the cost of occupation to be calculated.

It must be recognised that benefits are derived over a long timescale. Major restructuring of large and complex estates cannot be achieved quickly, but with professional help, significant benefits will be forthcoming.

PUBLIC REPORTING ON FINANCES

Developments in the style of public reporting by agencies and departments to expose the financial position and annual performance achieved to public scrutiny has further encouraged a climate of openness and public accountability. The annual audited financial summary statements in Canada and the consolidated balance sheets prepared for the Crown in New Zealand represent significant developments here. Strengthened roles for government auditors and the increasing use of value-for-money reviews are further steps in this direction.